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No.

Supreme Court, U.S.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1992

PAUL L. HOFTYZER and ETHEL FAIRCLOTH,
Co-Administrators of the Estate of
Devin L. Faircloth, Deceased,

Petitioner,

v.

THE PRUDENTIAL INSURANCE COMPANY
OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF VIRGINIA

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QUESTIONS PRESENTED

1. Whether a common law cause of action for rescission, based on material misrepresentation, to rescind one employee's participation in an employee welfare benefit plan is preempted by the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. §1144.

2. Whether a common law cause of action for rescission is "saved" by the ERISA savings provision as a law regulating insurance, 29 U.S.C. §1144(b)(2)(A).

3. Whether a state law rescission action conflicts with the comprehensive scheme developed by Congress for the protection of employees' interests in their benefit plans and circumvents enforcement of the fiduciary's duties under ERISA.

PARTIES TO THE PROCEEDING

1. The Estate of Devin L. Faircloth, by its co-Administrators, Paul L. Hoftyzer and Ethel Faircloth, Petitioner.

2. The Prudential Insurance Company of America, Respondent.

Page

TABLE OF CONTENTS

QUESTIONS PRESENTED. i

PARTIES TO THE PROCEEDING. ii

PROCEEDINGS BELOW 2

STATEMENT OF JURISDICTION. 2

STATUTORY PROVISIONS. 2

STATEMENT OF THE CASE 6

REASONS WHY THE WRIT SHOULD BE GRANTED 12

ARGUMENT:

I. A Common Law Cause of Action Based on Material Misrepresentation To Rescind One Employee's Participation In An Employee Welfare Benefit Plan Is Preempted By ERISA. 12

II. Prudential's Cause of Action For Rescission Is Not "Saved" By The ERISA Savings Provision 18

III. A State Law Rescission Action Conflicts With The Comprehensive Scheme Developed By Congress For The Protection Of Employees' Interests In Their Benefit Plans And Circumvents Enforcement Of The Fiduciary's Duties Under ERISA 23

CONCLUSION 27

REQUEST FOR RELIEF 28

CERTIFICATE OF SERVICE 29

APPENDICES:

Appendix A – Respondent's Bill of Complaint filed on June 15, 1990 1

Appendix B – Petitioner's Answer, Grounds of Defense and Cross-Bill of Complaint filed on August 3, 1990 . . . 4

Appendix C – Letter of Opinion of the Circuit Court for the City of Alexandria, Virginia dated September 4, 1991. 12

Page

Appendix D – Judgment Decree of the Circuit Court for the City of Alexandria, Virginia entered October 9, 1991. 15

Appendix E – Order of the Supreme Court of Virginia denying discretionary review dated April 21, 1992. 18

TABLE OF AUTHORITIES

Adkins v. Reliance Standard Life Ins. Co., 917 F.2d 794 (4th Cir. 1990) 25

Alessi v. Raybestos-Manhattan, Inc., 451 U.S. 504 (1981). . . . 13

Blau v. Del Monte Corp., 748 F.2d 1348 (9th Cir. 1984), *cert. denied*, 474 U.S. 865 (1985). 15

Cantrell v. Great Republic Ins. Co., 873 F.2d 1249 (9th Cir. 1989) 15

Caterpillar v. Williams, 482 U.S. 386 (1987). 16

C. Colteryahn Dairy v. Teamsters & Emp. Pension Fund, 847 F.2d 113 (3rd Cir. 1988), *cert. denied*, 488 U.S. 1041 (1989). 22

Cromwell v. Equicor-Equitable HCA Corp., 944 F.2d 1272 (6th Cir. 1991), *petition for cert. filed*, 60 U.S.L.W. 3447 (Dec. 3, 1991). 14, 16

Davis v. Kentucky Finance Cos. Retirement Plan, 887 F.2d 689 (6th Cir. 1989), *cert. denied*, 110 S.Ct. 1924 (1990). 15

Ellenburg v. Brockway, Inc., 763 F.2d 1091 (9th Cir. 1985) 22

Farlow v. Union Central Life Ins. Co., 874 F.2d 791 (11th Cir. 1989) 15, 16

Firestone Tire & Rubber v. Bruch, 109 S.Ct. 948 (1989). 14, 21, 24, 25

Fischman v. Blue Cross Blue Shield, 755 F. Supp. 528 (D. Conn. 1990) 20

FMC Corp. v. Holliday, 111 S.Ct. 403 (1990). 13, 19

Cases, continued: Page

Herrmann Hospital v. MEBA Medical & Benefits Plan, 845 F.2d 1286 (5th Cir. 1988). 16

Howard v. Gleason Corp., 901 F.2d 1154 (2nd Cir. 1990). . . . 19

Ingersoll-Rand v. McClendon, 111 S.Ct. 478 (1990). 24

Kaiser Steel Corp. v. Mullins, 455 U.S. 72 (1982) 21

Knutz v. Reese, 760 F.2d 926 (9th Cir. 1985), *vac'd on other grnds*, 785 F.2d 1110 (9th Cir.), *cert. denied*, 479 U.S. 916 (1986) 15

Kunin v. Benefit Trust Life Ins. Co., 910 F.2d 534 (9th Cir. 1990), *cert. denied*, 111 S.Ct. 581 (1990) 25

Martin v. Pate, 749 F. Supp. 242 (S.D. Ala. 1990), *aff'd sub nom, Martin v. Continental Investors*, 934 F.2d 1265 (11th Cir. 1991) 16, 22

Memorial Hospital System v. Northbrook Life Ins. Co., 904 F.2d 236 (5th Cir. 1990) 13, 17

Metropolitan Life Insurance Company v. Taylor, 481 U.S. 58 (1987) 13

Nash v. Trustees of Boston University, 946 F.2d 960 (1st Cir. 1991) 21

Perkins v. Time Ins. Co., 898 F.2d 470 (5th Cir. 1990). . . 15, 17

*Perry v. P*I*E Nationwide, Inc.*, 872 F.2d 157 (6th Cir. 1989), *cert. denied*, 110 S.Ct. 1166 (1990) 16, 17

Phillips v. Amoco Oil, 799 F.2d 1464 (11th Cir. 1986), *cert. denied*, 481 U.S. 1016 (1987). 15

Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41 (1987). 13, 18, 19, 21

Pitts. v. American Security Life, 932 F.2d 351 (5th Cir. 1991) 22

Reilly v. Blue Cross Blue Shield, 846 F.2d 416 (7th Cir.), *cert. denied*, 488 U.S. 856 (1988). 15

Saladino v. I.L.G.W.U. National Ret. Fund, 754 F.2d 473 (2nd Cir. 1985). 14

Schulist v. Blue Cross, 553 F. Supp. 248 (N.D. Ill. 1982), *aff'd*, 717 F.2d 1127 (7th Cir. 1983). 21

Cases, continued: Page

Shaw v. Delta Airlines, Inc., 463 U.S. 85 (1983) 13

Simmons v. Prudential Insurance, 641 F. Supp. 675 (D. Colo. 1986) 20

Sixty-Five Security Plan v. Blue Cross, 583 F. Supp. 380 (S.D.N.Y. 1984) 21

Thayer v. Group Hospitalization and Medical Services, 674 F. Supp. 924 (D.D.C. 1987) 20

Federal Statutes:

McCarren-Ferguson Act, 15 U.S.C. § 1011, *et seq.* 18

28 U.S.C. § 1257. 2

Employee Retirement Income Security Act,
29 U.S.C. § 1001 *et seq.* 2, 6
§ 1001(b). 23
§ 1002. 2
§ 1104(a). 3, 23
§ 1132(a). 4, 20, 21, 27
§ 1132(e). 5, 21
§ 1144. . . . . 5, 10, 13, 18

State Statutes:

Va. Code § 38.2-309 (1950, as amended). 10, 19

Va. Code § 38.2-3326 (1950, as amended) 10, 19

Va. Code § 38.2-3528 (1950, as amended) 10, 19

Treatises:

Restatement (Second) of Trusts § 187 (1959). 24

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v.

THE PRUDENTIAL INSURANCE COMPANY
OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF VIRGINIA

COME NOW Paul L. Hoftyzer and Ethel Faircloth, Co-Administrators of the Estate of Devin L. Faircloth, and submit this Petition for Writ of Certiorari requesting that the Supreme Court grant a Writ of Certiorari, reverse and remand the case, and reconsider the Virginia Supreme Court and lower court decisions.

PROCEEDINGS BELOW

The Virginia Supreme Court denied discretionary review of the Petitioner's Petition for Appeal on April 21, 1992, in an unreported opinion. Appendix E at 18a. The Trial Court, the Alexandria Circuit Court, entered its final judgment in an unreported decision on October 9, 1991. Appendix D at 15a.

STATEMENT OF JURISDICTION

This Court has jurisdiction on Writ of Certiorari pursuant to 28 U.S.C. §1257. The underlying litigation involved Petitioner's rights under the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. §1001 *et seq.* The Virginia Supreme Court denied discretionary review of Petitioner's claim in an unreported decision on April 21, 1992. Appendix E.

STATUTORY PROVISIONS

29 U.S.C. §1002

> (1) The terms "employee welfare benefit plan" and "welfare plan" mean any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers,

scholarship funds, or prepaid legal services, or (B) any benefit described in section 186(c) of this title (other than pensions on retirement or death, and insurance to provide such pensions).

* * *

(7) The term "participant" means any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit.

* * *

(21) (A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 1105(c)(1)(B) of this title.

* * *

29 U.S.C. §1104(a)

(1) Subject to sections 1103(c) and (d), 1342 and 1344 of this title, a fiduciary shall discharge his duties

with respect to a plan solely in the interest of the participants and beneficiaries and –

(A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; . . .

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter or subchapter III of this chapter. . . .

29 U.S.C. §1132(a)

A Civil action may be brought –

(1) by a participant or beneficiary –

(A) for the relief provided for in subsection (c) of this section, or

(B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan;

(2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title;

(3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress

such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan;

* * *

29 U.S.C. §1132(e)

(1) Except for actions under subsection (a)(1)(B) of this section, the district courts of the United States shall have exclusive jurisdiction of civil actions under this subchapter brought by the Secretary or by a participant, beneficiary, or fiduciary. State courts of competent jurisdiction and district courts of the United States shall have concurrent jurisdiction of actions under subsection (a)(1)(B) of this section. . . .

29 U.S.C. §1144

(a) Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. This section shall take effect on January 1, 1975.

(b) . . .

(2)(A) Except as provided in subparagraph (B), nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities. . . .

(c) For purposes of this section:

(1) The term "State law" includes all laws, decisions, rules, regulations, or other State action having the effect of law, of any State. . . .

STATEMENT OF THE CASE

On June 15, 1990, the Prudential Insurance Company filed a Bill of Complaint against Devin L. Faircloth[1] stating a common law cause of action for rescission in the Circuit Court for the City of Alexandria. Respondent sought to rescind policies of health and life insurance issued to Faircloth, alleging that his policies were void for material misrepresentations on his application. Appendix A at 1a. The Bill of Complaint at ¶ ¶ 2-3 stated that Faircloth is employed by the Sheridan Group and that "Prudential provides an Employee Benefit Plan (EBP) to employees of Sheridan" which offers both health and life insurance. *Id.* Prudential did not seek to rescind the entire employee welfare benefit plan, but only Faircloth's participation in that plan. The Petitioner filed his Answer and a Cross-Bill of Complaint on August 3, 1990. Appendix B at 4a. Petitioner asserted that the Employee Retirement Income Security Act ("ERISA") preempted the cause of action stated in the Respondent's Bill of Complaint. *Id.* at 6a. Faircloth's Cross-Bill was an action brought under ERISA, 29 U.S.C. §1001 *et seq.* to recover benefits due him under the terms of the plan, and to enforce his rights under the terms of the plan. *Id.*

On July 16, 1991, Faircloth filed a Motion to Dismiss Prudential's Bill of Complaint for Lack of Subject Matter Jurisdiction, stating that ERISA preempted Prudential's cause of action, and that under ERISA, the Respondent as an ERISA fiduciary was precluded from pursuing an action in state court. Faircloth also filed a Motion in

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[1] Faircloth deceased while his case was pending on a petition for appeal in the Virginia Supreme Court. The Estate of Devin L. Faircloth by its co-Administrators was duly substituted as the party-Petitioner in that court.

Limine to preclude as evidence at trial Faircloth's application for insurance under the employer's group plan.[2] On July 19, 1991, the trial court heard evidence on Faircloth's Motion to Dismiss for Lack of Subject Matter Jurisdiction, taking that motion and the Motion in Limine under advisement. The court then heard evidence on both the Bill of Complaint and Cross-Bill, contingent upon his ruling on Faircloth's motions raising the jurisdictional and evidentiary issues. Ultimately, the court ruled that ERISA did not preempt Prudential's cause of action, and entered judgment for the Respondent. Appendices C at 12a and D at 15a.

In support of his Motion to Dismiss for Lack of Subject Matter Jurisdiction, Faircloth introduced testimony by the Corporate Secretary of his employer, the Sheridan Group, and testimony by deposition of Prudential's corporate designee. Prudential presented no evidence in opposition to the Motion to Dismiss.

Faircloth had been a full time employee (vice president) of the Sheridan Group since March of 1987. He was so employed when Sheridan obtained its contract of group insurance with Prudential. The Corporate Secretary for Sheridan submitted the application for the company's group insurance with Prudential. Sheridan obtained the insurance for the benefit of its employees to provide for medical, surgical, and hospital care and

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[2] Prudential filed its common law cause of action on the last day of the contestability period, as stated in the terms of the plan. Since Prudential's cause of action was void, having been preempted by ERISA and filed in a court without the power to hear it, a contest under the plan was only initiated by the filing of Faircloth's ERISA cause of action, which occurred after the two year period of contestability. Therefore, the application should have been precluded as evidence at trial.

benefits, and a life insurance policy. Under the contract with Prudential, Sheridan was responsible for paying the premiums for the insurance. Sheridan paid the premiums from its general revenues.

Prudential sent to Sheridan summary plan descriptions, which describe the benefits and coverages under the plan, for distribution to Sheridan's employees. Prudential prepared the summary plan descriptions, along with various forms, information and instructions for administration of the group plan contained in the employer's Administration Guide.[3] Under the group plan, employees submitted their medical claims directly to Prudential. Prudential made the final determination whether any claim was payable.

Sheridan's employee welfare benefit plan included individual underwriting on all employees. At trial, Prudential claimed that Faircloth did not state on his application that he had tested positive for antibodies to the Human Immuno Deficiency Virus ("HIV"). The application contained no questions inquiring about a HIV status, AIDS or any other related conditions.

Faircloth tested positive for the HIV antibody[4] in the fall of 1986. The application for the insurance was

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[3]The Administration Guide prepared by Prudential and given to Sheridan included a document entitled "Impact of ERISA on Employee Benefit Plans," which stated on page 4, that "Prudential is the claims fiduciary". Exh. E. The evidence established that Prudential exercises discretionary authority and responsibility with respect to the control, management and administration of the plan. Prudential held sole discretionary authority with respect to the granting or denying of claims made under the plan, and in the review of denied claims.

[4]There exists no test for the actual *presence* of the HIV in the human body. The tests used by physicians and clinics, the Western Blot and ELISA, can only detect the presence of antibodies developed to the virus, indicating a prior exposure.

completed in April of 1988. Faircloth presented evidence at trial, subject to his continuing objections stated in his Motion in Limine and Motion to Dismiss, that he had been told by persons conducting the HIV tests in 1986 that the positive test result meant only that he had been exposed to the HIV virus and his body had developed antibodies to it. Faircloth testified that he was told the positive test result did not mean that he harbored or had the virus itself, but had the potential to get it. Nor did the positive test result mean that he had a disease or was sick. Faircloth's treating physician told him that he was in very good health, and that he should have regular visits to his office. Between his first visit with that physician in the fall of 1986 and April of 1988 when the application for insurance was completed, his physician did not state otherwise. In the applicable time, Faircloth recalled that he had learned that approximately 20-25% of those persons testing positive to the HIV antibody test would develop symptomatology or AIDS.

Faircloth's testimony was corroborated by Prudential's corporate designee and Prudential's claim memorandum relating to misrepresentation, AIDS and related conditions. That memorandum embodied Prudential's policy developed in 1986 that persons who are HIV positive were not insurable, and specifically stated that "perhaps only 20% of those who test positive will develop AIDS within the next five years."[5] The memorandum was dated 1987 and reflected the state of the art of medical information at that time. Prudential's corporate

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[5]Medical knowledge about the HIV and the possibility of developing AIDS after a positive test result has changed significantly. The state of medical information in 1987 was that 20% of persons testing HIV positive would develop AIDS. By 1991, statistics from the Center for Disease Control were indicating 99% of persons with positive test results had a possibility of developing AIDS.

designee testified that the positive test result to the HIV antibody "reflects an indication of a serious disorder in the future" and had "nothing to do with the individual's present condition." The question at issue on the application concerned *present* health and read, "Has any person to be covered any deformity or any indication of a physical or mental disorder or any disease not disclosed in the answers" to other questions. Exh. 1. Both the application and the plan documents stated the representations on the application are true "to the best of [the applicant's] knowledge and belief." Exh. I at BR841A; Exh. 1.

Having taken under advisement the Motion to Dismiss for Lack of Subject Matter Jurisdiction and the Motion in Limine, the trial court issued his opinion letter on September 4, 1991, finding that:

> [A] cause of action brought by an insurer for rescission of the contract based on fraud is not preempted by the [Employee Retirement Income Security] act. The purpose of the statutory scheme to make uniform the treatment received by employees under retirement plans is not served by preemption of a cause of action directed at determining whether or not coverage exists in the first instance. Further, Virginia's statutes on fraudulent applications for insurance coverage and incontestability found at Title 38.2, Code of Virginia, §§309, 3528 and 3326 are statutes that regulate insurance and are "saved" from preemption by the so-called "savings" clause of Title 29 U.S.C. §1144(b)(2)(A).

Appendix C at 13a 14a. Thereafter, Faircloth filed a Motion for Clarification and Reconsideration requesting the trial court to make specific findings related to its ruling on the preemption issue, specifically with respect to the Sheridan Group plan constituting an employee welfare benefit plan within the meaning of ERISA, that Pruden-

tial is a fiduciary within the meaning of that term in ERISA, and that Faircloth's insurance was issued as part of the Sheridan Group plan. The trial court stated from the bench that those findings were implied in his letter opinion, and that

> [T]he preemption question wasn't ruled on because you were lacking in proof as to any one of those three matters. I was just re-reading my letter . . . it really is not clear, but it certainly is implicit in that and that is certainly what I meant.

Transcript of Hearing on October 9, 1991 at 3. The court further stated, "this is not a case where I denied your Motion to Dismiss . . . on the basis that you failed to prove any one of those three essential elements". *Id.* at 6. Final order was entered by the Alexandria Circuit Court on October 9, 1991. Appendix D at 15a.

Faircloth duly noted his appeal, and on January 9, 1992, filed his petition for appeal in the Supreme Court of Virginia, assigning as error that, "the trial court lacked subject matter jurisdiction to hear Prudential's Bill of Complaint and erred as a matter of law in failing to dismiss Prudential's Bill of Complaint." Arguing for that first assignment of error, Faircloth stated "the trial court erred in denying Faircloth's Motion to Dismiss for Lack of Subject Matter Jurisdiction since Prudential's cause of action is preempted by ERISA." Petition for Appeal to the Supreme Court of Virginia at 1, 13, respectively. Faircloth further argued that Prudential's cause of action for rescission was not "saved" by ERISA's savings clause, that Prudential had an available cause of action under ERISA and that a common law rescission action interferes with the comprehensive scheme developed by Congress for the protection of employees' interests in employee benefit plans. The Virginia Supreme Court denied discretionary review by Order dated April 21, 1992.

REASONS WHY THE WRIT SHOULD BE GRANTED

The issue involved in this case, whether an action for rescission for material misrepresentation is preempted by the Employee Retirement Income Security Act, is an important federal question which requires resolution by this Court. The Court has not addressed this specific issue, and unless the issue is finally resolved the state courts will apply their own substantive law to such cases, resulting in a lack of uniform regulation. More importantly, as occurred in this case, application of state law to this issue ignores ERISA's mandated duty of loyalty of insurer/fiduciaries to participants in a plan.

The circuit courts of appeal, in considering this type of common law cause of action, have split in determining whether it is preempted by ERISA. The decisions rendered by the Virginia Supreme Court and the lower court in this case conflict with the majority rule in the circuit courts of appeal holding the common law cause of action preempted. Cases involving insurer/fiduciaries seeking rescission for misrepresentation of participants in an employee welfare benefit plan are occurring more frequently in the lower courts, and guidance from this Court is necessary to resolve the issue.

ARGUMENT

I.

A COMMON LAW CAUSE OF ACTION BASED ON MATERIAL MISREPRESENTATION TO RESCIND ONE EMPLOYEE'S PARTICIPATION IN AN EMPLOYEE WELFARE BENEFIT PLAN IS PREEMPTED BY ERISA.

In ERISA Congress set out to protect the interests of participants in employee welfare benefit plans, by a comprehensive scheme of regulation and enforcement. The Federal statute supersedes "any and all State laws insofar

as they may now or hereafter relate to any employee benefit plan . . ." 29 U.S.C. §1144(a). The "preemption clause is conspicuous for its breadth." *FMC Corporation v. Holliday,* 111 S.Ct. 403, 407 (1990). The deliberately expansive language was "designed to 'establish pension plan regulation as exclusively a Federal concern.' " *Pilot Life Insurance Co. v. Dedeaux,* 481 U.S. 41, 46 (1987), *quoting Alessi v. Raybestos-Manhattan, Inc.,* 451 U.S. 504, 523 (1981).

In *Pilot Life,* the Plaintiff had brought common law causes of action for tortious breach of contract, breach of fiduciary duties, and fraud in the inducement. 481 U.S. at 45. This Court stated, "the common law causes of action raised in *Dedeaux*'s complaint, . . . undoubtedly meet the criteria for preemption . . ." *Id.* at 49; *see Metropolitan Life Ins. Co. v. Taylor,* 481 U.S. 58, 62 (1987). The term "relates to" is to be given a broad common sense based meaning. A law relates to an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan. *Shaw v. Delta Airlines, Inc.,* 463 U.S. 85, 96-97 (1983). In *Memorial Hospital System v. Northbrook Life Ins. Co.,* 904 F.2d 236, 245 (5th Cir. 1990), the Fifth Circuit identified two unifying characteristics of claims held to be preempted: (1) the state law claims address areas of exclusive Federal concern, such as the right to receive benefits under the terms of an ERISA plan; and (2) the claims directly affect the relationship among the traditional ERISA entities – the employer, the plan and its fiduciaries, and the participants and beneficiaries.

Given its common-sense meaning, the cause of action for rescission at issue here clearly "relates to" an employee welfare benefit plan. Prudential issued Faircloth's certificate of insurance as part of the plan. To

interpret the plan provisions, the court must review the plan documents for its terms which provide for individual underwriting and which provide the standard by which an applicant's statements are to be judged, that they are true "to the best of his knowledge and belief." The plan itself was that obtained by the employer, Sheridan. Prudential sought only to rescind the participation of one participant, Faircloth. Distilled to its essence, Prudential's claim was for a determination that Faircloth had no rights to benefits under the employee welfare benefit plan, alleging that the policy was void for material misrepresentation. This is simply the reverse of Faircloth's own Cross-Bill of Complaint brought to enforce his rights and obtain his benefits under ERISA. The label placed upon the claim is irrelevant; what is at issue is whether the claim in essence falls at the heart of the ERISA regulation. *See, e.g., Cromwell v. Equicor-Equitable HCA Corp.*, 944 F.2d 1272, 1276 (6th Cir. 1991), *petition for cert. filed,* 60 U.S.L.W. 3447 (Dec. 3, 1991). The issue of whether a participant has any rights to benefits in his plan clearly falls at the heart of the ERISA regulatory scheme. The conduct of an insurer as a fiduciary in seeking rescission is an area of exclusive federal concern. *See infra* Section III. Prudential's cause of action for rescission clearly affects the relationship between ERISA principals – the insurer/fiduciary and the participant, Faircloth.[6]

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[6]The term "participant" is defined at 29 U.S.C. §1002(7). In *Firestone Tire & Rubber v. Bruch,* 109 S.Ct. 948 (1989), this Court stated "the term 'participant' is naturally read to mean . . . 'employees in, or reasonably expected to be in, currently covered employment.' " *Id.* at 957-8, *quoting Saladino v. I.L.G.W.U. National Retirement Fund,* 754 F.2d 473, 476 (2nd Cir. 1985). Faircloth was an employee in covered employment and therefore a participant in the employee welfare benefit plan.

Although the circuit courts of appeal have split, a majority of courts considering claims similar to that at bar, of misrepresentation or fraudulent inducement, have held such causes of actions preempted by ERISA. *See, e.g., Cantrell v. Great Republic Ins. Co.*, 873 F.2d 1249 (9th Cir. 1989) (employee's common law action for wrongful rescission held preempted; policy issued was part of employee benefit plan); *Farlow v. Union Central Life Ins. Co.*, 874 F.2d 791, 794 (11th Cir. 1989) (claims of misrepresentation and negligence against agent and insurer causing Plaintiffs to enter the plan held preempted); *Davis v. Kentucky Finance Cos. Retirement Plan*, 887 F.2d 689, 696 (6th Cir. 1989), *cert. denied*, 110 S.Ct. 1924 (1990) (claim of equitable estoppel based on misrepresentation brought by beneficiary held preempted); *Reilly v. Blue Cross Blue Shield*, 846 F.2d 416 (7th Cir.), *cert. denied*, 488 U.S. 856 (1988) (claims of breach of fiduciary duty, conspiracy, fraud and bad faith brought by participant against plan insurer for denial of claims held preempted); *Phillips v. Amoco Oil*, 799 F.2d 1464 (11th Cir. 1986), *cert. denied*, 481 U.S. 1016 (1987) (common law fraud claims based on concealment of effect of a sale of a business would have on retirement held preempted); *Knutz v. Reese*, 760 F.2d 926 (9th Cir. 1985), *vac'd on other grnds*, 785 F.2d 1410 (9th Cir.), *cert. denied*, 479 U.S. 916 (1986) (fraud and misrepresentation arising pre-plan enrollment as to fact and quality of coverage held preempted); *Blau v. Del Monte Corp.*, 748 F.2d 1348 (9th Cir. 1984), *cert. denied*, 474 U.S. 865 (1985) (promissory estoppel, fraud and deceit held preempted). *Contra Perkins v. Time Ins. Co.*, 898 F.2d 470 (5th Cir. 1990) (claim against a non-ERISA fiduciary, but agent soliciting for the plan for fraudulent inducement held not preempted; claim against agent does not affect the relations among

the ERISA principals; but claim against plan insurer for misrepresentation held preempted); *Perry v. P*I*E Nationwide, Inc.*, 872 F.2d 157 (6th Cir. 1989), *cert. denied*, 110 S.Ct. 1166 (1990) (employees sued to rescind entire plan for fraud inducing them to participate in employee stock investment program; fraud and misrepresentation claims held not preempted because Plaintiffs had no remedy under ERISA);[7] *Martin v. Pate*, 749 F. Supp. 242 (E.D. Ala. 1990), *aff'd sub nom, Martin v. Continental Investors*, 934 F.2d 1265 (11th Cir. 1991) (court considers defense of fraud and rescission in ERISA action, but the plaintiff's claim of fraud in the inducement against agent and insurer for representations made inducing them to enroll in the plan foregoing other insurance coverage held not preempted; refusing to follow *Farlow, supra*, holding fraud in the inducement claims are preempted). The circuits have also split on factual scenarios involving misrepresentation claims brought by a health care provider holding an assignment for misrepresentation of the fact of coverage. *Compare Cromwell v. Equicor-Equitable HCA Corp.*, 944 F.2d 1272 (breach of contract, promissory estoppel, negligence and bad faith causes of actions arising from misrepresentation as to insurance coverage; suit brought by health care provider holding assignment; held preempted); *and Herrmann Hospital v. MEBA Medical & Benefits Plan*, 845 F.2d 1286, 1291 (5th Cir. 1988) (breach of fiduciary duty, negligence, equitable estoppel, fraud held preempted; suit brought by health care provider with assignment for plan's misrepresentation of coverage);

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[7] *But cf. Cromwell*, 944 F.2d at 1276 (where Sixth Circuit stated that it is irrelevent to the analysis of the scope of Federal preemption that the appellants may be left without a remedy, relying upon *Caterpillar, Inc. v. Williams*, 482 U.S. 386 (1987)).

with Memorial Hospital System, 904 F.2d 236 (health care provider with assignment from plan participant claimed misrepresentation by insurer under Texas statute; hospital called employer to verify insurance coverage and was told the individual was covered; statutory claim for misrepresentation held not preempted, but state law claims asserted as assignee of plan beneficiary are preempted).

Thus, most courts considering similar causes of action have held those causes of action preempted. *Perkins* found to the contrary only with regard to a non-ERISA entity. There the Fifth Circuit found no preemption of the action brought against an individual who was merely an agent soliciting for the plan. But, the insured's claim in that same case against the insurer/fiduciary of the plan for misrepresentation inducing plan enrollment was held preempted. 878 F.2d at 473. In *Perry*, the employees sought to rescind the entire plan, a factual circumstance significantly different from that at bar. P*I*E had told employees the company would close if they refused to take the reduction in pay and participate in a stock investment program, and that the company would not be sold. P*I*E subsequently sold the company and the employees sued to rescind the plan. The Sixth Circuit held that the employees' claims of breach of fiduciary duty and lack of consideration were preempted by ERISA. 872 F.2d at 161. But as to the claim for fraud and misrepresentation based on representations made in obtaining plaintiffs' agreement to participate in the plan, the court held that those claims were not preempted because "preemption should apply to a state law claim only if Congress has provided a remedy for the wrong or wrongs asserted." *Id.* at 162. The Sixth Circuit has since abandoned that position. *See supra* note 7. The case at bar

is significantly different from *Perry* and *Perkins*. Here the insurer sought to rescind only the participation of one employee in the plan; the insurer is clearly an ERISA entity, a fiduciary, and as is apparent in Section II *infra* the insurer/fiduciary has a remedy in ERISA. Prudential's cause of action of rescission, seeking to rescind one participant's participation in the employee welfare benefit plan, undoubtedly relates to the plan and is, therefore, preempted by ERISA.

II.

PRUDENTIAL'S CAUSE OF ACTION FOR RESCISSION IS NOT "SAVED" BY THE ERISA SAVINGS PROVISION.

ERISA's savings provision excepts from the preemption clause laws that "regulate insurance." 29 U.S.C. §1144(b)(2)(A). As in *Pilot Life*, a common sense view of the phrase "regulates insurance" fails to support any argument that a common law cause of action for rescission falls under the savings clause. A rescission action is firmly rooted in general principles of contract law. It applies to any contract – not merely to insurance contracts. Material misrepresentation or fraud, upon which the rescission action is based, is similarly firmly rooted in the general principles of tort law and is applied to a myriad of types of circumstances – not merely to those related to insurance.

For the analysis under the savings clause, this Court has incorporated the interpretations of the phrase "business of insurance" under the McCarren-Ferguson Act, 15 U.S.C. §1011 *et seq.* *Pilot Life*, 481 U.S. at 49. Three criteria have been used: (1) whether the practice has the effect of transferring or spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and

(3) whether the practice is limited to entities within the insurance industry. *Id.* These McCarren-Ferguson factors do not support the application of the savings clause. Neither the common law cause of action of rescission, nor the common law cause of action for misrepresentation pool or average policyholder risk. Although rescission and misrepresentation may concern the relationship between the insured and the insurer, as stated in *Pilot Life*, those causes of action are "no more 'integral' to the insurer-insured relationship than any state's general contract [or tort] law is integral to a contract made in that state." 481 U.S. at 52. With respect to the third McCarren-Ferguson factor, these common law causes of action of misrepresentation or rescission are neither directed nor limited to entities within the insurance industry. Any contract may be avoided on misrepresentation grounds.

Although this plan is based upon an insurance product, and the insurance product must comply with state insurance regulations, *FMC Corp. v. Holliday*, 111 S.Ct. 403 (1990), that fact does not affect the cause of action which must be alleged for enforcement. One of the statutes involved here merely codifies the common law of misrepresentation with some limitations, *see* Va. Code §38.2-309 (statements deemed representations and not warranties; to bar recovery must clearly prove the answer was material to the risk and untrue). Va. Code §§38.2-3326 and 38.2-3528 merely require group policies to contain a provision that the policy is incontestable after a two year period. Even though the statutes may be "saved"[8] and the insurance product itself

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[8]Not all insurance statutes themselves are "saved". In *Howard v. Gleason Corp.*, 901 F.2d 1154 (2nd Cir. 1990), the court held that a state law requiring notice of right to convert a

[footnote continued]

must comply with the statutory mandate, that merely means the plan incorporates the substance of the statutes as plan terms, as was done here. However, that does not affect the cause of action that must be alleged where an employee welfare benefit plan is involved. Congress has provided an exclusive remedy for all such matters, whether brought by a participant/beneficiary such as Faircloth, or by a fiduciary, such as Prudential. Common law causes of action are not regulations or statutes regulating the business of insurance within the meaning of the savings clause, and are not saved from ERISA's preemption clause. The fiduciary's sole source of relief is through ERISA.

Although in the courts below, the Respondent claimed it did not have a remedy under ERISA, that is clearly contrary to the law. The statute expressly provides that a civil action may be brought by a fiduciary to obtain equitable relief to enforce any terms of a plan, and one of the plan terms here was the individual underwriting clause. 29 U.S.C. § 1132(a)(3). As an insurer having sole discretionary control and authority over payment or denial of claims, Prudential is clearly a fiduciary within the meaning of the Act. Indeed, its own documents admitted that "Prudential is the claims fiduciary."[9] As

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group policy to an individual life insurance policy was preempted and not saved in ERISA. The court found that ERISA contained elaborate provisions concerning the content and timing of notice of plan information to be given participants, and the statute conflicted with the ERISA provisions. In *Fischman v. Blue Cross Blue Shield*, 755 F. Supp. 528 (D. Conn. 1990), the court held that the Connecticut Unfair Insurance Practices Act was preempted; it did not regulate insurance.

[9] For cases holding that insurers are fiduciaries based upon claims payment discretion, *see, e.g., Thayer v. Group Hospitalization and Medical Services*, 674 F. Supp. 924, 925 (D.D.C. 1987); *Simmons v. Prudential Insurance*, 641 F. Supp. 675 (D. Colo.

[footnote continued]

a fiduciary, Prudential may bring a suit for equitable relief in Federal court under ERISA's civil enforcement scheme and may be sued, as in Plaintiff's Cross-Bill of Complaint.[10]

Thus, through an ERISA action, Prudential could have used its material misrepresentation claim as a defense to Faircloth's Cross-Bill of Complaint or Prudential could have brought its own action in Federal Court seeking the equitable relief of rescission. The Federal courts are to develop a Federal common law of rights and obligations under ERISA. *Firestone*, 109 S.Ct. at 954; *Pilot Life*, 481 U.S. at 56. Traditional concepts of contract law may inform the developing Federal common law. Since rescission is a remedy available in equity for fraud or material misrepresentation, it is clearly among the equitable remedies that a federal court may fashion in an ERISA action – whether considered as a defense, or as an affirmative action brought by the insurer seeking rescission. In developing the Federal common law under ERISA, many courts have considered equitable remedies. *See, e.g., Kaiser Steel Corp. v. Mullins*, 455 U.S. 72 (1982) (applying an equitable defense of illegality in an action under ERISA and the federal labor laws); *Nash v. Trustees of Boston University*, 946 F.2d 960 (1st Cir. 1991) (fraudulent inducement of contract in an ERISA action; so central a contract

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1986); *Sixty Five Security Plan v. Blue Cross*, 583 F. Supp. 380 (S.D.N.Y. 1984); *Schulist v. Blue Cross*, 553 F. Supp. 248 (N.D. Ill. 1982), *aff'd*, 717 F.2d 1127 (7th Cir. 1983).

[10] However, unlike the participant, Faircloth, a fiduciary may only bring an action in Federal court. 29 U.S.C. §1132(e)(1) specifically provides that concurrent jurisdiction in a state court lies only for a claim under (a)(1)(B) brought by a participant or beneficiary to recover benefits under the plan.

principle should be included in the developing federal common law for ERISA); *Pitts v. American Security Life*, 931 F.2d 351 (5th Cir. 1991) (equitable defense of void contract seeking rescission under ERISA; insurer defended that the policy was void *ab initio* for material misrepresentations of the employer); *C. Colteryahn Dairy v. Teamsters & Emp. Pension Fund*, 847 F.2d 113 (3rd Cir. 1988), *cert. denied*, 488 U.S. 1041 (1989) (ERISA action for misrepresentation and fraud in the inducement under §1451 for fraud on employer committed by multi-employer pension fund); *Ellenburg v. Brockway, Inc.*, 763 F.2d 1091 (9th Cir. 1985) (equitable doctrine of unclean hands used preventing recovery in an ERISA action by an employee who misrepresented age on his application); *Martin v. Pate*, 749 F. Supp. at 244 n.2 (rescission issue based on misrepresentation of a medical condition as a defense within the ERISA action; law of avoidance treated as part of the new Federal common law being developed under ERISA).

Thus, Prudential's cause of action was preempted by ERISA, and was not exempt from preemption by ERISA's savings clause. Prudential had an available remedy under ERISA's civil enforcement provisions. Prudential's sole remedy was an action brought in federal court under ERISA.

III.

A STATE LAW RESCISSION ACTION CONFLICTS WITH THE COMPREHENSIVE SCHEME DEVELOPED BY CONGRESS FOR THE PROTECTION OF EMPLOYEES' INTERESTS IN THEIR BENEFIT PLANS AND CIRCUMVENTS ENFORCEMENT OF THE FIDUCIARY'S DUTIES UNDER ERISA.

In developing ERISA, Congress intended to "protect... the interest of participants in employee benefit plans and their beneficiaries . . . by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions and ready access to the Federal courts." 29 U.S.C. §1001(b). Under ERISA, the insurer/fiduciary has a duty of loyalty. The insurance company must comply with a Federally mandated standard of conduct. The fiduciary must act in the best interest of plan participants and beneficiaries, and in accordance with the act and with plan documents. 29 U.S.C. §1104(a). As both an insurance company and a fiduciary under ERISA, Prudential has an inherent conflict of interest with the participant. Thus, this duty of loyalty is a significant departure from its normal course of business. The insurer's best interest is to deny claims and make a profit, and to seek rescission of policies of persons with costly medical conditions and thereby make a profit. The participant's best interest is served by maintaining his coverage and by payment of claims, reducing the insurer's profit. Where an insurer/fiduciary seeks rescission of one participant from an employee benefit plan, a court must consider any equitable relief only in the context of ERISA's fiduciary duty of loyalty, using the enforcement scheme Congress provided. Moreover, where the fiduciary has an inherent conflict of interest, as is obvious with any insurer in an insurance based plan, that conflict of interest

is one factor that must be taken into consideration. *See* Restatement (Second) of Trusts §187, Comment d (1959); *See also Firestone*, 109 S.Ct. at 956.

The fiduciary's duty of loyalty is undoubtedly one reason Congress has vested exclusive jurisdiction in the federal courts for actions brought by fiduciaries. Otherwise, there is the potential for conflict in substantive law applied to the standard of conduct. State courts in exercising their common law powers might develop different substantive standards applicable to the same fiduciary conduct, which would be fundamentally contrary to the uniformity that Congress sought to implement. In *Ingersoll-Rand v. McClendon*, 111 S.Ct. 478 (1990), the Court applied this rationale, but it is equally applicable here.[11] Although a common law cause of action for rescission may provide for the same remedy as an ERISA action for rescission, the substantive standards that might be applied will be considerably different. Under state law, an insurer acting solely as an insurance company has no duty of loyalty to an insured. But under ERISA, the duty of loyalty of the fiduciary lies at the heart of the Congressional regulatory scheme, and provides the methodology for the protection Congress sought to provide participants in their employee benefit plans.

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[11] There, the Court considered a Texas statute consistent with ERISA's substantive requirement that established liability for wrongful discharge arising out of a pension benefits issue. The Court held that there was potential for conflict in substantive law applied to the action. It is foreseeable that state courts might develop different substantive standards applicable to the same employer conduct, requiring the tailoring of plans and employer conduct to the peculiarities of the law of each jurisdiction. Such an outcome is fundamentally at odds with the goal of uniformity that Congress sought to implement. *Ingersoll-Rand*, 111 S.Ct. at 484.

Moreover, although the courts are to develop a Federal common law of rights and obligations under ERISA, *Firestone,* 109 S.Ct. at 954, and although that Federal common law may be informed by state law, no particular state law applies. The Ninth Circuit recently noted that neither the law of the state in which the federal court sits, nor that of any other state applies to a plan of its own force. *Kunin v. Benefit Trust Life Ins. Co.,* 910 F.2d 534, 539 (9th Cir.), *cert. denied,* 111 S.Ct. 581 (1990). The court further noted disagreement as to whether a uniform Federal rule of construction applies in construing ambiguous provisions in an ERISA insurance contract or whether the applicable state rule of construction is incorporated into Federal law for that purpose. *Id.* In *Kunin* it made no difference because the rule of law applied, that ambiguities in an insurance contract must be construed against the insurer, is adhered to by all states and the District of Columbia. In *Adkins v. Reliance Standard Life Ins. Co.,* 917 F.2d 794 (4th Cir. 1990), the Fourth Circuit created Federal common law for the interpretation of a plan clause on pre-existing conditions. This case arose from a Southern District of West Virginia decision. The Fourth Circuit declined to apply the Virginia rule used by the district court, and instead used an interpretation of pre-existing condition clauses from Kentucky. The court stated that adoption of the Kentucky rule, which is less stringent than that of the Virginia rule, gave effect to this Court's admonition in *Firestone* to promote the interests of the employees and beneficiaries in employee benefit plans. *Id.* at 797.

The fiduciary duty of loyalty and standard of conduct towards plan participants lies at the heart of the Congressional scheme to protect the interest of employees in their benefit plans. In the welfare plan context, this

duty of an insurer/fiduciary did not exist pre-ERISA. It marks a substantial departure from state law; a departure mandated by Congress. Conduct of an ERISA fiduciary is exclusively an area of federal concern, evidenced by precluding fiduciary suits in state courts. An action to rescind one participant from participation in a plan inherently implicates the ERISA duty of loyalty. These considerations require preemption of a common law cause of action seeking to rescind the participation of one employee in a plan. Without preemption of such actions, the individual states will apply their own substantive law to such common law actions, thereby ignoring the ERISA duty of loyalty and defeating the purposes of Congress in protecting the interests of employees in their employer sponsored plans. ERISA provides a remedy for the insurer/fiduciary as part of its enforcement provisions. Any action for rescission brought by a fiduciary must comply with the federal statute and be considered only by a Federal court in the context of ERISA's fiduciary duty of loyalty and the developing Federal common law. In a case such as that at bar, the court must consider the actual questions asked by the insurer on the application form along with the plan terms such as that involved here, that the statements made are to the applicant's best knowledge and belief, in considering whether the remedy of rescission is appropriate and consistent with the insurer's duty of loyalty to plan participants. In this case, since the trial court determined that ERISA did not preempt the common law action of rescission, ERISA's fiduciary duty of loyalty was wholly ignored. Such a decision is at odds with the Congressional mandate and purposes underlying ERISA.

CONCLUSION

Given its common sense meaning, it is apparent that this common law cause of action for rescission "relates to" an employee welfare benefit plan. Faircloth's certificate of insurance was issued as part of the plan, and the plan terms must be resorted to for interpretation by the court. The issue of whether a participant has any rights to benefits under his plan falls at the heart of ERISA and is an exclusive federal concern. Moreover, the ERISA savings provisions does not exempt this common law cause of action for rescission from the scope of the preemption clause. A cause of action for rescission for material misrepresentation is not a law "regulating insurance," considered either with its common sense meaning or the McCarren-Ferguson factors. Rescission and misrepresentation are not directed specifically to the insurance industry, but rather are firmly rooted in common law concepts of tort and contract law applicable to a myriad of types of circumstances.

Furthermore, Prudential as an ERISA fiduciary had an available remedy under ERISA, 29 U.S.C. §1132(a)(3). The courts in developing the federal common law to determine the rights and obligations under ERISA have readily applied traditional equitable concepts, either as a defense or as an affirmative action brought by the insurer/fiduciary. Any action for rescission must be brought only in a federal court and considered in the context of the ERISA-fiduciary's duty of loyalty to plan participants. For an insurer/fiduciary that duty of loyalty is a significant departure from state common law. As occurred in this case, state courts considering such matters will merely apply their own state rule of law and ignore ERISA's standard of conduct found in

the duty of loyalty. The duty of loyalty is the methodology by which Congress sought to protect the interests of participants in their employee benefit plans. Permitting a state court to ignore that duty and apply its own law, outside the ERISA context, conflicts with and defeats the purposes of Congress in developing the ERISA comprehensive enforcement scheme. For the reasons stated herein, the state courts below erred in holding that ERISA did not preempt Prudential's common law cause of action.

REQUEST FOR RELIEF

WHEREFORE, Petitioner requests that this Honorable Court grant the Writ of Certiorari, reconsider and reverse the decisions of the Virginia Supreme Court and the lower court and remand for trial.

Respectfully submitted,

PATRICIA A. SMITH
SANDERS, O'DONNELL & SMITH
515 King Street, Suite 400
Alexandria, Virginia 22314
(703) 549-2080
Counsel for Petitioner.

July 17, 1992

CERTIFICATE OF SERVICE

I hereby certify that three copies of the foregoing Petition for Writ of Certiorari to the Supreme Court of Virginia have been mailed first class, postage pre-paid, in accordance with Supreme Court Rule 29.3, to counsel for the Respondent, listed below, on this 17th day of July, 1991.

Lonnie D. Nunley, Esquire
Hunton & Williams
Riverfront Plaza
East Tower
951 East Byrd Street
Richmond, Virginia 23219-4074

BY:

_____

for PATRICIA A. SMITH

APPENDIX A

VIRGINIA: [Filed June 15, 1990]

IN THE CIRCUIT COURT
OF THE CITY OF ALEXANDRIA

Chancery No. 900414

THE PRUDENTIAL INSURANCE
COMPANY OF AMERICA,

Plaintiff,

v.

DEVIN FAIRCLOTH,

Defendant.

BILL OF COMPLAINT

Plaintiff The Prudential Insurance Company of America (Prudential), by counsel, moves for judgment against the defendant, Devin Faircloth (Faircloth), granting rescission of an insurance policy. Prudential states as follows in support of its Bill of Complaint:

1. Faircloth is a resident of the Commonwealth of Virginia.

2. Faircloth is employed by the Sheridan Group (Sheridan), located at 2715 South Inge Street, Arlington, Virginia 22202.

3. Prudential provides an Employee Benefit Plan (EBP) to employees of Sheridan pursuant to Policy No. EBP 632736T (Contract). The Contract offers both life and health insurance coverage.

4. On April 15, 1988, Devin Faircloth applied to Prudential for coverage under the Contract. A copy of the

Application is attached hereto as Exhibit A. Faircloth's Application requested Employee Term Life Insurance in the amount of $5,000.00 and Health Care Coverage.

5. Faircloth's Application contained misrepresentations, concealments and omissions of material facts concerning Faircloth's past and present medical condition and treatment.

6. Prudential relied on the Application and was induced by it to enter the Contract.

7. The facts misrepresented, concealed and omitted were material to Prudential's decision to enter the Contract.

8. Had Faircloth properly responded to the Application, Prudential would not have entered the Contract.

9. Prudential has been damaged, and will be damaged in the future, by its reliance on the misrepresentations, concealments and omissions contained in the Application.

10. Faircloth's misrepresentations, concealments and omissions of material facts in his Application constitute fraud in the inducement and are grounds for rescission of the Contract.

WHEREFORE, the Prudential Insurance Company of America, by counsel, respectfully requests that this Court rescind coverage of Policy No. EBP 632736T to Devin Faircloth and grant such other relief as it deems fit, to include the costs associated with this case.

THE PRUDENTIAL INSURANCE
COMPANY OF AMERICA

By /s/ Lonnie D. Nunley, III
Lonnie D. Nunley, III

Lewis T. Booker
Lonnie D. Nunley, III
HUNTON & WILLIAMS
707 East Main Street
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APPENDIX B

[Filed Aug 3, 1990]

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

In Chancery No. CH900414

PRUDENTIAL INSURANCE COMPANY
OF AMERICA,

Plaintiff/Counter-Defendant,

v.

DEVIN L. FAIRCLOTH,

Defendant/Counter-Plaintiff.

ANSWER AND GROUNDS OF DEFENSE
AND CROSS BILL OF COMPLAINT

COMES NOW the Defendant, DEVIN L. FAIRCLOTH, by counsel, and states the following in and for his answer in response to the Bill of Complaint filed by the Plaintiff:

1. Admitted.

2. Admitted.

3. Admitted.

4. Defendant admits that on April 15, 1988, an enrollment form was completed for him by an agent of the Plaintiff for coverage under the group contract. Exhibit A is neither authentic nor legible and the Defendant therefore denies it is a true and accurate copy of the original.

5. The allegations of paragraph number 5 are denied.

6. Defendant is without sufficient information to admit or deny the averments contained in paragraph 6.

7. The allegations of paragraph number 7 are denied.

8. Defendant is without sufficient information to admit or deny the allegations of paragraph number 8.

9. Defendant is without sufficient information to admit or deny the allegations of paragraph number 9.

10. The allegations of this paragraph constitute a mere legal conclusion and therefore a response is unnecessary. To the extent any response is required, Defendant denies the allegations of this paragraph.

FIRST DEFENSE

The Complaint fails to state a claim upon which relief may be granted.

SECOND DEFENSE

The Defendant intends to rely upon the affirmative defense of estoppel.

THIRD DEFENSE

The Defendant intends to rely upon the affirmative defense of illegality.

FOURTH DEFENSE

The Defendant intends to rely upon the affirmative defense of waiver.

FIFTH DEFENSE

The Defendant intends to rely upon the defense of the Statute of Limitations.

SIXTH DEFENSE

The claim asserted in the Bill of Complaint is preempted by the Employee Retirement Income Security Act, 29 U.S.C. §1001, *et seq.*

SEVENTH DEFENSE

The defendant intends to rely upon Va. Code §§38.2-3327, 38.2-3328, 38.2-3402, and 38.2-3529.

EIGHTH DEFENSE

The Defendant intends to rely upon the terms of the contestability clauses contained in the contract which prohibit Plaintiff from relying upon statements contained in the application and other explicit language of the contract which is consistent with the statutes cited above.

WHEREFORE, Defendant respectfully prays this Court to dismiss the Bill of Complaint, and grant him his costs and attorneys fees incurred herein, and for such other and further relief as the nature of the case may require and to equity may seem meet.

CROSS BILL OF COMPLAINT
(Violation of the Employee Retirement Income Security Act)

1. This is a civil action arising under the provisions of the Employment Retirement Income Security Act, Title 29 §1001, *et seq.* of the United States Code by a participant of an Employee Welfare Benefit Plan to recover benefits due him under the terms of the plan, to enforce his rights under the terms of the plan, to clarify his rights to future benefits under the terms of the plan, to obtain damages incurred as a result of the violation, and for other appropriate equitable and legal relief.

2. Counter-Plaintiff DEVIN L. FAIRCLOTH, is a resident of the Commonwealth of Virginia.

3. Defendant, PRUDENTIAL INSURANCE COMPANY OF AMERICA is the insurer underwriting the employee welfare benefit plan, and does business in the Commonwealth of Virginia.

4. Counter-Plaintiff entered the employ of the Sheridan Group as associate vice president on March 3, 1989, and has remained in the continuing employ of the Sheridan Group since that time.

5. In consideration of employment services rendered and to be rendered by the Counter-Plaintiff, Sheridan Group maintains certain employee benefits programs.

6. The Sheridan Group funded the benefits from its general assets, along with contributions by employees.

7. On or about June 15, 1988, the Sheridan Group and Counter-Defendant PRUDENTIAL LIFE INSURANCE COMPANY entered into a contract of group insurance for the purpose of providing insurance for medical, surgical, hospital care and benefits in the event of sickness, injury or death of an employee. The plan was established and maintained by the employer Sheridan. The plan is administered by Counter-Defendant PRUDENTIAL LIFE INSURANCE COMPANY. Intended benefits are for Sheridan's employees and their dependents. Premiums were paid by the employer, with contributions by the employees, and the employer maintained the plan.

8. The contract of group insurance represents an employee welfare benefit plan as defined by Title 29, §1002(1) of the United States Code and is subject to various provisions of that Act, including the fiduciary duties and the enforcement provisions of Part 5 of that Act.

9. Individuals covered by the employee welfare benefit plan are full-time employees of Sheridan and their qualified dependents.

10. By virtue of his full-time employment with Sheridan, and in consideration of services rendered and to be rendered, Counter-Plaintiff was covered by the medical and life insurance policies under the contract of group insurance between Sheridan and PRUDENTIAL.

11. On or about June 15, 1988, a certificate of insurance was issued to Counter-Plaintiff under the group policies for life insurance and for medical insurance.

12. The Certificate of Coverage constituted the employee welfare benefit Summary Plan Description distributed to employee participants.

13. By terms of the plan, Counter-Plaintiff received coverage for life insurance in the amount of $5,000, medical care and hospitalization benefits and dental benefits. Claims of participants were submitted to Counter-Defendant, PRUDENTIAL.

14. Commencing in September of 1989, Counter-Plaintiff submitted claims under the Plan's health coverage.

15. Under the terms of the Plan, said claims were to be paid upon PRUDENTIAL's receipt of proof of loss.

16. Commencing in January 1990, PRUDENTIAL informed Sheridan it would no longer accept premiums for Plaintiff's coverages.

17. In March of 1990, Defendant PRUDENTIAL orally informed Plaintiff that it denied the claims submitted, because they were for treatment for a disease that existed prior to his application for coverage.

18. Contrary to the terms of the Plan, and without any legal justification or excuse, Defendant PRUDEN-

TIAL denied said claims and continues to refuse to pay the claims submitted by Counter-Plaintiff.

19. The employee welfare benefit plan contains a pre-existing condition clause with a limitation of one year. Counter-Plaintiff has satisfied the pre-existing condition clause.

19. The action of Counter-Defendant PRUDENTIAL in denying said claims is in bad faith.

20. In violation of the Employee Retirement Income Security Act, Defendant PRUDENTIAL failed to place the denial in writing or to provide Counter-Plaintiff with an appeal process for review of the denial of the claims.

21. Defendant PRUDENTIAL unlawfully, arbitrarily, capriciously and in bad faith refused to pay the benefits due Counter-Plaintiff that were conferred by the express terms of the Plan.

22. The Plan was in full force and effect and continues to be in full force and effect at the time the claims were insurred and submitted. The Plan by its express terms is binding on PRUDENTIAL.

23. Counter-Defendant PRUDENTIAL is a fiduciary within the meaning of the Employee Retirement Income Security Act.

24. Counter-Defendant PRUDENTIAL violated its fiduciary duties to act in accord with Plan documents and to act in the best interests of the beneficiaries of the Plan by failing to pay the benefits due Counter-Plaintiff and in failing to provide an appeal process for the denial of the claims.

25. Counter-Plaintiff had faithfully performed all obligations as conditions precedent to coverage under the Plan; the terms of the Plan are binding as to benefits conferred.

26. Counter-Plaintiff demanded the health benefits under the Plan, but Counter-Defendant PRUDENTIAL refused.

27. Counter-Defendant is HIV positive, with prescribed AZT, and the actions of the Counter-Defendant have caused and will continue to cause irreparable harm as he is now uninsurable elsewhere.

28. As a direct and proximate consequence of the conduct of Counter-Defendant PRUDENTIAL, the Plaintiff has suffered and will continue to suffer mental and emotional distress, anxiety, medical expenses and the denial of insurance benefits.

WHEREFORE, Counter-Plaintiff prays that:

A. This Court decree and reinstate retroactively Counter-Plaintiff's contractual rights to benefits under the employee welfare benefit plan and order specific performance of the contract;

B. This Court award judgment against Counter-Defendant PRUDENTIAL in the amout of $50,000 compensatory damages;

C. This Court order Counter-Defendant PRUDENTIAL to pay all medical claims covered by the contract of insurance and submitted by Counter-Plaintiff, along with interest, as provided by Virginia State law;

D. This Court award costs and attorneys fees as specificially provided in 29 U.S.C.A. §1132(g); and

E. This Court provide such additional and further equitable and legal relief as the nature of the case may require and to equity may seem meet.

Respectfully submitted,
DEVIN L. FAIRCLOTH
By Counsel

SANDERS, O'DONNELL & SMITH
By:

/s/ Patricia A. Smith
Patricia A. Smith

/s/ Dale Edwin Sanders
Counsel for Defendant
116 South Pitt Street
Alexandria, Virginia 22314
(703) 549-2080

CERTIFICATE OF SERVICE

I hereby certify that on this 3 day of August, 1990, a copy of the foregoing Answer and Grounds of Defense and Counterclaim was mailed first class, postage prepaid, to Lonnie D. Nunley, III, Esquire, Hunton & Williams, 707 East Main Street, P.O. Box 1535, Richmond, Virginia 23212.

/s/ Patricia A. Smith
Patricia A. Smith

APPENDIX C

CIRCUIT COURT OF ALEXANDRIA
VIRGINIA

[Seal]

September 4, 1991

Judges
DONALD HALL KENT
DONALD M. HADDOCK
ALFRED D. SWERSKY

FRANILIN P. BACKUS
Judge Retired

Courthouse
520 King Street
Alexandria, Virginia
22314-3164
(703) 838-4123

Lonnie D. Nunley, III, Esquire
Brian V. Otero, Esquire
Hunton & Williams
Riverfront Plaza, East Tower
951 East Byrd Street
Richmond, Virginia 23219-4074

Patricia A. Smith, Esquire
Dale Edwin Sanders, Esquire
Sanders, O'Donnell & Smith
515 King Street, Suite 400
Alexandria, Virginia 22314

Re: Prudential Insurance Co. v. Faircloth
Chancery No. CH900414

Dear Counsel:

This action to rescind coverage under a contract for life and health insurance was taken under advisement after hearing a motion to dismiss by Defendant and a

trial on the merits, the Court having reserved its ruling on the motion.

Prudential alleges that Faircloth's application for coverage under a life and health care plan offered to his employer "contained misrepresentations, concealments and omissions of material facts concerning Faircloth's past and present medical conditions and treatment." Prudential sought to prove that Faircloth had been found HIV positive prior to his application for coverage and failed to reveal this in response to a question in the application as to whether he had "any indication of any physical or mental disorder or any disease not disclosed in the answers . . . ."

Defendant claims and bases his motion to dismiss on a lack of subject matter jurisdiction, arguing that this common law action for rescission has been pre-empted by the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1001, *et seq.*

The authorities are widely split as to the extent of the causes of action that have been pre-empted by this statutory scheme. While no Virginia cases dealing directly with this issue have been presented, both sides presented authorities that seem to support their arguments. However, the Court finds that a cause of action brought by an insurer for rescission of the contract based on fraud is not pre-empted by the act. The purpose of the statutory scheme to make uniform the treatment received by employees under retirement plans is not served by pre-emption of a cause of action directed at determining whether or not coverage exists in the first instance. Further, Virginia's statutes on fradulent applications for insurance coverage and incontestability found at Title 38.2, Code of Virginia, § § 309, 3528 and 3326 are statutes that regulate insurance and are "saved" from pre-

emption by the so-called "savings" clause of Title 29, U.S.C. §1144(b)(2)(A).

Further, under the law of this Commonwealth the fraud, if shown, would void the contract *ab initio* and no contract would exist between the parties. See, *Hawkeye-Sec Ins. Co. v. Government Employees Ins. Co.*, 207 Va. 944 (1967).

Defendant's *Motion in Limine* to bar use of the statements contained in his application will be denied since the Court has found that the Complainant has properly filed this action and it is within the time provided for contesting the policy.

Turning to the merits, Complainant has show that Defendant was tested and found to be HIV positive in October of 1986. His application was filed with Prudential in April of 1988 and the evidence reveals that he was further tested in September and December of 1987; that he saw his physician on eight separate occasions between October 1986 and the date of the application; that Faircloth knew or had been advised as to the then state of the knowledge of the effects of being HIV positive; and that on his application he advised that he had seen his doctor only one time for "preventive medicine physical, 4/87, Dr. Warren Chamberline (sic)."

Thus, the statements on Faircloth's application are untrue and are clearly material to the risk assumed by Prudential. §38.2-309.

Judgment will be rendered in favor of Complainant on its bill for rescission. Judgment will be rendered against Defendant on his crossbill.

Mr. Nunley should prepare an appropriate decree noting Defendant's objections.

Very truly yours,

/s/ Alfred D. Swersky
Alfred D. Swersky

APPENDIX D

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

In Chancery No. CH900414

THE PRUDENTIAL INSURANCE
COMPANY OF AMERICA,

Plaintiff,

v.

DEVIN L. FAIRCLOTH,

Defendant.

JUDGMENT DECREE

On July 19, 1991, the parties, The Prudential Insurance Company of America (Prudential), plaintiff, and Devin L. Faircloth (Faircloth), defendant, each represented by counsel, appeared for trial on Prudential's Bill of Complaint and Faircloth's Cross-Bill of Complaint.

The parties argued Faircloth's Motion to Dismiss and Motion In Limine; the Court took each under advisement.

Prudential presented its evidence in support of its Bill of Complaint. At the close of Prudential's evidence, Faircloth moved to strike Prudential's evidence. Said motion was denied.

Faircloth presented evidence in opposition to the Bill of Complaint and in support of the Cross-Bill. At the close of Faircloth's evidence, Prudential moved to strike

Faircloth's evidence and for a summary judgment in its favor. Said motion was denied. The Court then took the matter under advisement. The parties filed post-trial memoranda.

On the basis of the evidence presented, the memoranda presented and the argument of counsel, and for the reasons set forth in this Court's September 4, 1991, letter opinion, which is incorporated into this Decree by reference, it is hereby ORDERED that:

1. Faircloth's Motion to Dismiss is denied;

2. Faircloth's Motion In Limine is denied;

3. Prudential's Bill of Complaint is granted; and

4. Faircloth's Cross-Bill of Complaint is denied.

ACCORDINGLY, the insurance contract between Prudential and Faircloth is found to have been void *ab initio* and the same is rescinded. Prudential shall recover its costs in this action from Faircloth.

The Clerk is directed to send certified copies of this Judgment Decree to counsel of record.

/s/ Alfred D. Swersky

The Honorable Alfred D. Swersky, Judge
Circuit Court for the City of Alexandria

DATE: 10/9/91

A COPY TESTE:
Edward Semonian, Clerk
By /s/ Shirley D. Jacobs
Deputy Clerk

SEEN:

/s/ Lonnie D. Nunley, III
Lonnie D. Nunley, III
Brian V. Otero
HUNTON & WILLIAMS
707 East Main Street
P.O. Box 1535
Richmond, Virginia 23212
(804) 788-8200
Counsel for The Prudential Insurance Company of America

SEEN AND OBJECTED TO AS REGARDS DENIAL OF THE MOTION TO DISMISS, DENIAL OF THE MOTION IN LIMINE, AND DENIAL OF FAIRCLOTH'S CROSS-BILL OF COMPLAINT:

/s/ Patricia A. Smith
Dale Edwin Sanders
Patricia A. Smith
SANDERS, O'DONNELL & SMITH
515 King Street, Suite 400
Alexandria, Virginia 22314
Counsel for Devin L. Faircloth

APPENDIX E

VIRGINIA:

In the Supreme Court of Virginia held at the Supreme Court Building in the City of Richmond on Tuesday *the* 21st *day of* April, 1992.

Paul Hoftyzer, et al., etc., Appellants,

against Record No. 920050
Circuit Court No. CH900414

Prudential Insurance Company of America, Appellee.

From the Circuit Court of the City of Alexandria

Upon review of the record in this case and consideration of the argument submitted in support of and in opposition to the granting of an appeal, the Court is of opinion there is no reversible error in the judgment complained of. Accordingly, the Court refuses the petition for appeal.

A Copy,
Teste:
David B. Beach, Clerk
By:
/s/
Deputy Clerk